



# Commonwealth of Massachusetts State Ethics Commission

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## CONFLICT OF INTEREST OPINION EC-COI-95-8

### FACTS:

You are counsel to a high ranking state employee.<sup>1/</sup> Your client has a 5% ownership interest in ABC Inc. (ABC). He is not an officer or a director of ABC and has had no involvement in the management and control of ABC's business since resigning from its Board of Directors several years ago.

In 1989, state agency XYZ, awarded a multi-million consultant contract to a corporation for services related to a state project. In 1994, he learned that ABC was one of several subconsultants selected by that corporation in 1989.<sup>2/</sup> ABC was one of two firms listed in the direct expense budget submitted by the corporation for testing. The value of ABC's services was estimated at several thousand dollars.

Since the corporation's contract was first awarded, there have been no changes in ABC's scope of work or budget. Of the funds budgeted, ABC has received most of the fund allotted for that testing. Of that amount, approximately half was received after he became a management level official at XYZ.

During his tenure at XYZ, two modifications to the corporation's contract were voted by its board. The first extended the completion date for approximately two years. The second represented a multi-million increase in funds for extra work completely unrelated to ABC.

After assuming his current state position, he delegated all XYZ and related agency contract approvals to a subordinate and, since that date, has not seen any documents relating to the corporation's contract. However, he has been advised by his designee that there have been three additional modifications to the corporation's contract, none of which affected the scope or budget for ABC's work.

Despite steps taken by him to separate his private interests from his public responsibilities, and to be aware of and take appropriate action under Chapter 268A with regard to private interests he may have, he did not learn of ABC's subconsultant relationship to the corporation until a year ago. Therefore, to resolve all questions arising from his 5% interest ownership of ABC, and other financial interests he may be required by Chapter 268A to dispose of, he has created an irrevocable trust (Trust).

### The Trust

The Trust was created with your client as Settlor and First Beneficiary of the Trust. Other parties and his successors in trust are the Trustees. The Trust is irrevocable as he does not reserve the right to amend or revoke the Trust Agreement. Successor Trustees shall be designated in writing by the Policy Committee of a law firm (the Firm), or the immediate or remote successor to said firm.

From time to time, he will cause to be delivered to the Trust certain property which the Trustees shall receive and administer according to the terms of the Trust Agreement. Under that Agreement, the Trustees shall pay the net income of the Trust at least annually and shall, from time to time, pay to, or for the benefit of, the Secretary so much of the principal of the Trust as the Trustees, in their sole discretion, shall determine. The Trust Agreement further provides that the "Trustees shall segregate in a separate fund any property transferred to them by [your client] for the purposes of disposing of any financial interest he may have in such property to the extent required by Chapter 268A of the General Laws of Massachusetts." (Fund Property). You have confirmed that, pursuant to this provision, your client has placed in trust the stock representing his entire 5% interest in

ABC. The net income of the Fund Property (e.g., the Alpha stock) shall be paid at least annually to your client's spouse, who is listed as the Second Beneficiary. The Trustees have sole discretion to pay principal to or for the benefit of said spouse. Further, pursuant to G.L. c. 184B, which powers are expressly incorporated by reference in the Trust Agreement, the Trustees have power to "sell, exchange or otherwise dispose of the property at public or private sale on such terms as [they] may determine...." G.L. c. 184B, §2(1)(a). However, "[i]n the event the Trustees dispose of [the Fund Property] by sale, exchange, or otherwise, the proceeds of such disposition shall be deposited in trust for the benefit of [your client]." Additionally, if said spouse shall die before all of the Fund Property is distributed, and while your client occupies a position or office in the government of the Commonwealth that is inconsistent with the acquisition of a financial interest in any specific property in such trust corpus (Prohibited Position), such specific property shall be paid to said spouse's estate. If your client does not occupy a Prohibited Position at the time of his wife's death, the Fund Property shall be distributed to the Trust held for the benefit of him. Accordingly, there is the possibility that interests previously "disposed" of during his tenure as a state employee could revert to him.

## **QUESTION:**

Does G.L. c. 268A, §7 permit your client to dispose of financial interests in property to his wife under the circumstances described above?

## **ANSWER:**

No, unless he takes further steps to ensure that the prohibited financial interests do not revert to him.

## **DISCUSSION:**

Your client is a state employee<sup>3/</sup> for purposes of the conflict law. As such, he is subject to the restrictions of G.L. c. 268A, §7 which, with certain exceptions, prohibits a state employee from having a direct or indirect financial interest in a contract made by a state agency. As a 5% owner of ABC, which is a subconsultant under corporation's contract with state agency XYZ, he has an indirect financial interest in an XYZ contract. See, e.g., *EC-COI-83-5*; *82-117*. Because his ownership interest in ABC exceeds one percent,<sup>4/</sup> and as a high ranking state official, he participates in or has official responsibility for the activities of XYZ, he does not qualify for any of the exemptions to §7.<sup>5/</sup> Thus, §7(a) requires that he dispose of his interest in ABC's contract with the state. To this end, he has established a Trust which, in general, operates to pay and distribute to his spouse those financial interests which §7 prohibits him from retaining. As a result, we must first consider whether §7 permits a state employee to dispose of a prohibited financial interest in a state contract by creation of a trust, and second, whether, as spouses, his spouse's financial interest in the stock placed in trust should be imputed to your client for purposes of §7.

Turning to the first question, we note that this Commission has previously sanctioned disposition of a §7 prohibited financial interest through use of an irrevocable trust. Specifically, in *EC-COI-80-86*, a member of the judiciary was also a part owner of building, a portion of which was to be leased to a state agency. Upon execution of such a lease, the state employee would have a financial interest in a state contract in violation of §7. The question presented was whether, pursuant to §7(a), the state employee could transfer his interest in the building in trust for the benefit of his adult children and their issue. The state employee proposed two methods: (1) a so-called Clifford Trust whereby his interest in the building would be held in trust for a period of 10 years with all income paid or accumulated for the benefit of his adult children and their issue (i.e., until the state employee reached the state's mandatory retirement age for judges, whereupon his interest in the building would revert to him), or (2) an irrevocable trust for the benefit of his adult children and their issue.

In *80-86*, we concluded that a state employee does not "dispose of" a §7 prohibited financial interest simply by placing that interest out of his control for a term of years. Thus, we opined that where, under the Clifford Trust, ownership in the building would revert to the state employee, that employee would continue to have an indirect financial interest in the lease in violation of §7. However, we concluded that the irrevocable trust "would not offend §7 so long as the terms of the trust expressly provide that in no event could ownership of the property revert to [the state employee]."

While *80-86* provides some guidance for resolution of your client's situation, it is important to note that

that decision involved a trust for the benefit of emancipated *adult children* who presumably did not reside with, and who were not supported by, the state employee. In the instant case, we are asked to decide whether our reasoning in 80-86 is also applicable where the trust is for the benefit of the state employee's spouse. That is, we must ask whether the spouse's financial interest in the property placed in trust should be attributed to the state employee for purposes of §7.

As noted by one commentator, "section 7 does not automatically attribute the financial interest of the employee's wife ... to the employee himself. This should not mean, however, that the interest of a spouse ... must ... never be considered as the basis of an interest by the state employee himself. The test should be whether such an interest can fairly be said to be the employee's." Buss, *The Massachusetts Conflict of Interest Law: An Analysis*, 45 B.U. Law Rev. 299, 375 (1965). Recognizing this fact, we do not attribute to a state employee his spouse's financial interest in a state contract solely because of the marriage relationship. *EC-COI-83-123*; see also *EC-COI-84-13* ("In general, §7 does not prohibit both a husband and wife from serving as state employees, even with the same agency. While the husband obviously benefits from his wife's income (and vice-versa), the husband does not, strictly speaking, have a financial interest in his wife's employment contract with the state.") However, we have closely examined interspousal transfers of interests held by the state employee. See, e.g., *EC-COI-83-37*; *83-111*; *83-125*. Where there has been a divestiture of the state employee's interest to his spouse, we have looked at a number of factors to determine whether the state employee has truly transferred all right and title to the interest and any benefit that might flow from it, or whether the purported transfer is merely "a contrivance to evade the reach of the conflict of interest laws." *EC-COI-89-14*.

Our precedent regarding interspousal transfers has almost exclusively concerned the transfer of an interest in a going concern, where the state employee prior to the transfer has not only owned, but has played a role in the management and control of the business. In evaluating such transfers, we have looked to find evidence that the transferring spouse has relinquished all right, title and interest in the property and has ceased to deal with it as his own. Among the factors which we have considered in determining whether there has been a relinquishment of the interest are (1) the consideration paid by the transferee, (2) whether the state employee's initial investment has been liquidated, (3) whether the state employee continues to own the property transferred. Further, we have considered whether the state employee continues to participate in the management and control of the business, such that it can fairly be said that he continues to deal with the property as his own. *EC-COI-89-14*.

In certain cases, we have found that attribution was warranted. For example, in *EC-COI-83-37*, a state employee assigned to his wife his rights, title and interests as a general and limited partner in two limited partnerships, together with an irrevocable power of attorney. The limited partnerships were formed to develop real property using funding secured from a state agency. The wife was not involved in the work of the limited partnerships prior to the assignment and had no background, expertise or interest in real estate development. Further, the transfer to wife was without consideration and was made in part because she was someone the state employee could rely on to handle the project in the same manner as he. We concluded that the facts of the assignment were such that the state employee could "fairly" be said to still have a financial interest in the project funded by the state. This conclusion was based on our concern that despite the purported transfer of the interest, the transferring spouse continued to deal with the property as his own, albeit through his wife. In our view, that concern was warranted because the wife lacked the expertise to manage the business interest alone, and the absence of consideration paid by the wife to her husband was at least some evidence of the husband's failure to completely relinquish the interest.

We also found that attribution was warranted in *EC-COI-83-111*, where a state employee transferred his ownership interest in land formerly held jointly with his wife to his wife alone. The transfer was made to protect the land from being subject to any liability which the employee might incur in the performance of his state duties. Subsequently, his wife proposed to sell the property to the state agency that employed her husband. In attributing the wife's interest to her state employee husband, we noted that the transfer was not in return for any consideration, nor was its purpose to benefit the wife by giving her sole right and title to the land and all benefits which might come from it. Moreover, there was no independent evidence that the state employee husband had relinquished his financial interest in the proceeds of the wife's proposed sale to the Commonwealth. We said: "Absent evidence that you will not derive any financial benefit, direct or indirect, from the sale of the land, the Commission concludes that you will have a financial interest in the sale by your wife to [the state agency] in

violation of §7.” See also *EC-COI-83-125* (attribution found where state employee regularly participates in the company’s financial decisions); *85-24* (attribution found where employee shares in management and control of spouse’s business).

Turning to the issue at hand, we note that the question whether transfer of stock into an irrevocable trust for the benefit of one’s spouse constitutes “disposal” of that interest for purposes of the conflict law is a question of first impression for this Commission. As noted above, our prior precedent (other than *83-III*) has concerned transfers of interests in going concerns where the state employee’s management and control of that interest was a central factor in our analysis. In the present situation, his ability to manage and control ABC is derived from his stock in that company which he has now placed in trust for the benefit of his wife. Although this type of interspousal transfer has never been considered by this Commission, we think that the key question remains the same: can he fairly be said to have a financial interest in the property transferred. *EC-COI-84-13*.

As noted above, following our earlier precedent, we will not attribute his wife’s interest in this property to him solely because of the marital relationship, the extent to which husband and wife may share in common household expenses, or the equitable rights they may have in each other’s property. See Kindregan and Inker, *Massachusetts Practice: Family Law and Practice* §406 at pp. 17-18, Vol 2.; *deCastro v. deCastro*, 415 Mass. 787, 795 (1993). Rather, we will examine whether it can fairly be said that, apart from the mere fact of his marriage, your client retains a direct or indirect financial interest in the property held in Trust for the benefit of his wife. We conclude that, in general, the settlor of an irrevocable retains neither a direct nor an indirect financial interest in the property placed in trust. However, because the ABC stock placed in trust for his wife can revert to him, we conclude that the Trust does not dispose of the indirect financial interest in the state contract held by ABC. Thus, in order to comply with §7, your client must take further steps to ensure that the beneficial ownership of the property cannot revert to him.

By placing the ABC stock in an irrevocable trust, your client no longer holds legal title to that stock, nor is he the beneficial owner of it. *Welch v. Davidson*, 102 F.2d 100, 102 (1st Cir. 1939) (“in equity, the beneficiary of a trust is the owner of the trust res; ... he has an equitable estate in the property constituting the trust and is considered the real owner; ... the trustee, on the other hand, holds the legal title to the property with the right to administer it for the benefit of the beneficiary and in accordance with terms of the trust.”); see also *Markell v. Sidney B. Pfeiffer Foundation, Inc.*, 9 Mass. App. Ct. 412 (1980) (the legal effect of an irrevocable voluntary trust is to alienate the settlor’s power to control assets placed in trust). Furthermore, because the Trust is irrevocable, the transfer of stock into the Trust “§cannot be revoked or set aside at the will of [the settlor], *Lovett v. Farnham*, 169 Mass. 1, 2-3 [1897], § without proof of mental unsoundness, mistake, fraud or undue influence.” *Sands v. Old Colony Trust Co.*, 195 Mass. 575, 577 [1907], and cases cited.” *Clune v. Norton*, 306 Mass 324, 326 (1940). Moreover, to the extent that the ABC stock represents his legal right or entitlement to participate in ABC’s business decisions, your client has relinquished all such rights and entitlements. The Trustee, not your client, retains control over the administration of the ABC stock and the distribution of income derived therefrom to your client’s wife. Moreover, your client does not select successor trustees. Pursuant to G.L. c. 184B, the trustee may even sell the stock. Thus, unlike the case in *EC-COI-83-37* and *83-III*, your client has manifested some intention to give to his wife the financial interests that flow from the ABC stock and, in general, has done so in a manner where he does not retain control over the property transferred. In other words, despite a lack of consideration, the use of a trust vehicle creates a transaction that is different from the assignment for no consideration in *EC-COI-83-37* and the sale without consideration in *EC-COI-83-III*.

However, we are mindful that your client has not completely disposed of all interest in the ABC stock. For example, if the stock is sold, even while your client is a state employee and ABC is under contract with the state, the proceeds of the sale will be placed in trust for *his* benefit. Under another scenario, ownership of the stock could revert to him after a period of years. That is, if, after he leaves state service, his wife should predecease him, the property previously placed in trust for her benefit would not pass to her estate, but would be placed in trust for him. As we concluded in *EC-COI-80-86*, a trust that contains this type of reversionary interest does not obviate the §7 violation. That is, where such reversion is not merely possible but is expressly called for in the Trust Agreement, we think that it can fairly be said that the Secretary retains an indirect financial interest in the property. 2 Scott on Trusts, §128.2 (4th ed. 1982) (“if the settlor manifested an intention that the beneficiary should take the principal only if during his lifetime the trustee should elect to give it to him, [the beneficiary] has not the entire beneficial interest under the trust, and unless there is a gift over to a third person, the trustee will hold the property upon a resulting trust for the settlor or his estate.”) Accordingly, unless your

client takes additional steps to ensure that beneficial ownership of the property cannot revert to him, we conclude that he will continue to have an indirect financial interest in violation of §7.

**DATE AUTHORIZED:** June 6, 1995

<sup>1/</sup>The subject of this opinion has had other positions in state government, including a management position within the agency that he now oversees.

<sup>2/</sup>This opinion request was submitted shortly after he learned of ABC's subcontract.

<sup>3/</sup>"State employee," a person performing services for or holding an office, position, employment, or membership in a state agency, whether by election, appointment, contract of hire or engagement, whether serving with or without compensation, on a full, regular, part-time, intermittent or consultant basis, including members of the general court and executive council. No construction contractor nor any of their personnel shall be deemed to be a state employee or special state employee under the provisions of paragraph (o) or this paragraph as a result of participation in the engineering and environmental analysis for major construction projects either as a consultant or part of a consultant group for the commonwealth. Such contractor or personnel may be awarded construction contracts by the commonwealth and may continue with outstanding construction contracts with the commonwealth during the period of such participation; provided, that no such contractor or personnel shall directly or indirectly bid on or be awarded a contract for any construction project if they have participated in the engineering or environmental analysis thereof. G.L. c. 268A, §1(q).

<sup>4/</sup>Section 7 does not apply "if such financial interest consists of ownership of less than one percent of the stock of a corporation."

<sup>5/</sup>The §7(b) exemption is the only exemption generally available to regular state employees. Among other things, the §7(b) exemption requires that the state employee "not participate in or have official responsibility for any of the activities of the contracting agency."